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Retirement Choice: 2007

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15. SUBJECT TERMS
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Contents

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Introduction[1]

Military personnel who entered service after 31 July 1986 and who are eligible and intend to serve for 20 years must choose between two retirement plans at their 15th year of service.[2] Once the final selection is made, the choice is irrevocable. What are the options?

1. *High-3 retirement plan:* Retirement pay is based on the highest average basic pay for 36 months of a person's career. These are usually the last 3 years.

2. *REDUX retirement plan plus a $30,000 bonus that is given at the 15th year of service:* In return for accepting the bonus, REDUX provides smaller retirement checks.

How should Marines, Sailors, Airmen, and Soldiers decide which option to take? The Department of Defense has a website[3] that provides information and examples to help servicemembers. At the Center for Naval Analyses (CNA), we used a different approach that many have found useful in evaluating these retirement choices. Here we update that work for those making the decision in 2007.

We start by describing the bonus in the second choice as an early, partial cash-out of the servicemember's retirement pension. This $30,000 cash-out will be paid back later in the form of reduced retirement checks. By providing information on how much this cash-out will cost

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1. Our work benefited from the support and review of several CNA colleagues: Gerald Cox, Donald Cymrot, Michael Hansen, and Ann Parcell. Kathleen Utgoff (formerly Director of the Pension Benefit Guarantee Corporation), John Warner (Clemson University), Susan Woodward (formerly Chief Economist at the Security and Exchange Commission), Steve Cylke (Bureau of Naval Personnel), and Neil Singer (formerly Senior Defense Analyst at the Congressional Budget Office) provided critical insights. We thank them all for their help. The original paper was CNA Research Memorandum 3713.A1, published in April 2001 by Aline O. Quester and Lewis G. Lee.

2. Selection of the retirement plan begins at about 14.5 years of service.

3. The address of the DOD website is *http://www.defenselink.mil/militarypay/retirement/index.html.*

in smaller, future retirement income, we hope that we can help servicemembers make more informed decisions about which plan to select.

First, though, let's briefly look at the provisions of military retirement in general and then more specifically at the two plans. Both pension choices have the following features:

- Both provide retirement income as a percentage of the average of the highest 36 months of basic pay. There is no risk; the retirement payments are specified by law and guaranteed by the full faith and credit of the U.S. Government.
- Both offer deferred compensation for which no taxes are paid until the retired pay is received.[4] Such plans are called tax-sheltered retirement plans.
- Both are protected against inflation. The High-3 has full inflation protection because it changes yearly with the Consumer Price Index (CPI), while bonus/REDUX has less protection (CPI minus 1 percentage point). The value of inflation protection for retirement pay cannot be overemphasized. Most military members will be retired about 40 years. In 40 years, one can expect prices to increase at least four times, meaning what costs $1 at military retirement will end up costing $4.[5]

To summarize, military pensions are risk-free, tax-sheltered, inflation-adjusted annuities with options for spousal benefits (Survivor Benefit Plan) upon the death of the member. Such pension provisions are very expensive and are currently offered by only a few private-sector companies.

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4. The services pay into the retirement fund each year, and the fund grows while the member is in the service. The servicemember has no tax liability for the service's contributions to the retirement fund.

5. The Consumer Price Index in 2000 was over 5 times the level it was in 1960. This period includes the sharp inflation in 1974 (12.3 percent), 1979 (13.3 percent), and 1980 (12.5 percent). The commonly assumed 3.5-percent inflation rate leads to a fourfold increase in prices over a 40-year period.

How much is retirement income reduced under REDUX?

Against this backdrop, let's turn to the retirement choice in the 15th year of service. Choosing bonus/REDUX reduces income in retirement. The higher the grade and the lower the years of service at retirement, the greater the reduction in retirement income. In short, fast-trackers who retire very early are penalized most severely. For *all* military personnel, however, REDUX retirement income is *substantially smaller* than retirement income under the High-3 plan.[6] Moreover, as each year passes, the difference between retirement income under REDUX and retirement income under High-3 increases. For example, the *additional* reduction in retirement income under *REDUX* for those making the choice in 2007 (compared with 2001) is over $50,000 for virtually all retirees!

Some will find it easier to understand how the two plans differ by comparing verbal descriptions of the plans (table 1), whereas others will prefer to look at figures that describe the different retirement payments under the two plans (figures 1 through 4).

Table 1. Retirement choices for those who entered the service after 31 July 1986—based on highest average monthly basic pay over highest 36 months

	Retirement plan	
	High-3	REDUX + $30,000 bonus at 15 years of service
Percentage of basic pay at 20 years of service	50.0%	40.0%
Increase for each year of service past 20	2.5%	3.5%
At 30 years of service	75.0%	75.0%
Yearly cost-of-living adjustments	Full CPI[a]	CPI minus 1 percentage point
Age 62	Retirement payments set equal to each other at age 62 (see figures 1 through 4)	
Age 63 onward	Full CPI adjustments	CPI minus 1 percentage point

a. Consumer Price Index for urban wage earners and clerical workers.

6. Later in this paper, we discuss the thrift savings plan (TSP) and other investment options with the bonus. Thus, these examples assume that the servicemember pays taxes on, and spends, the bonus.

Let's look at some examples. To calculate the two retirement pay streams for someone at 15 years of service in 2007, we first need to make some assumptions. We assume the following:

- Military pay will grow at 3.5 percent per year until the servicemember retires.
- The CPI will grow at 3.5 percent per year.
- The servicemember will live to age 79.[7]
- Tax bracket[8]
  - Enlisted, 15 percent; after-tax bonus is $25,500
  - Warrant officers, 25 percent; after-tax bonus is $22,500
  - Commissioned officers, 28 percent: after-tax bonus is $21,600.

Figure 1 shows the two after-tax retirement pay streams, REDUX and High-3, from the first retirement year until age 79. We first look at an E-7 who expects to retire at age 38 with 20 years of service. We see a sharp reduction in retirement pay under REDUX until age 62, then a re-indexing that equates the two retirement pays, followed by a gradual erosion in REDUX retirement pay after age 62 when compared with High-3. For this servicemember, total retirement pay is reduced by $331,316 if REDUX/bonus is selected.

Figure 2 shows the difference in payments for a servicemember who expects to retire at age 42 as an E-8 with 24 years of service. Here the reduction in retired pay ($328,184) is just a little bit less than that for the E-7 who retires with 20 years of service (figure 1).

---

7. The Statistical Abstract of the United States, published in 2007, reports a life expectancy of an additional 39.5 years for someone age 40, so we have used an overall life expectancy of 79 years for military retirees. In a later section, we explore what happens if the servicemember lives past 79 years.

8. Later on, we discuss what happens if the $30,000 bonus is tax-free.

Figure 1. E-7 retiring at 38 with 20 years of service, 15% tax bracket

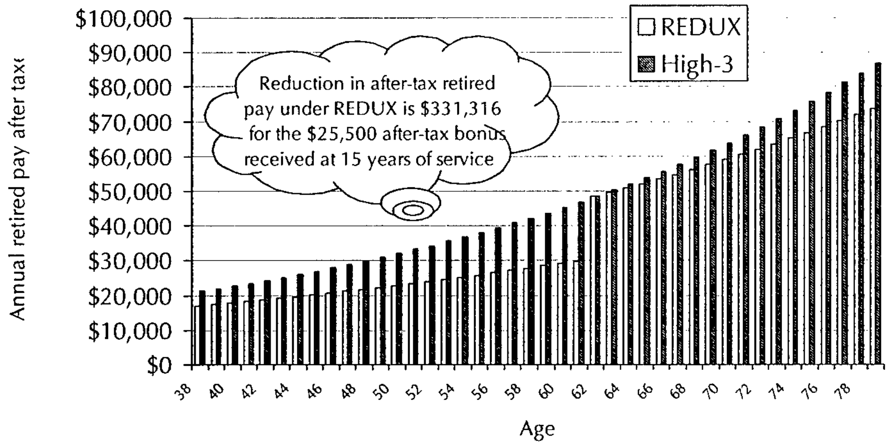


Figure 2. E-8 retiring at 42 with 24 years of service, 15% tax bracket

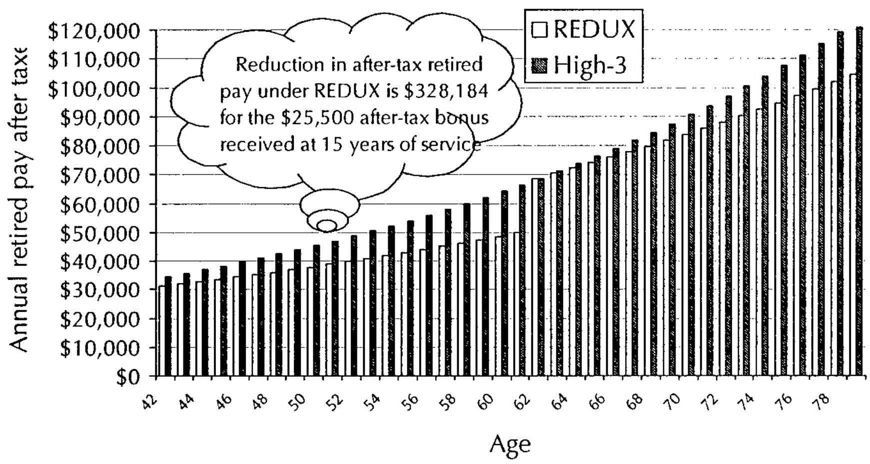


Figure 3 shows the situation for a CWO-3 who expects to retire at age 38 with 20 years of service. Here, the reduction in retirement pay is $383,743 under REDUX.

Figure 3. CWO-3 retiring at 38 with 20 years of service, 25% tax bracket

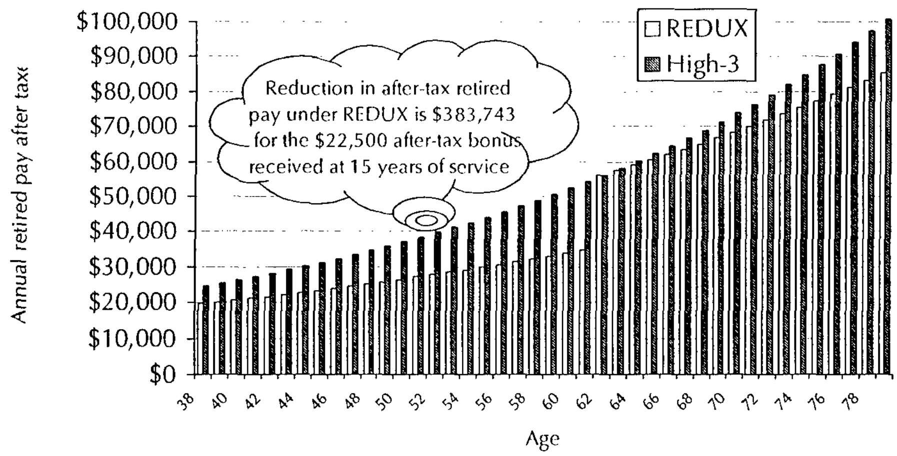
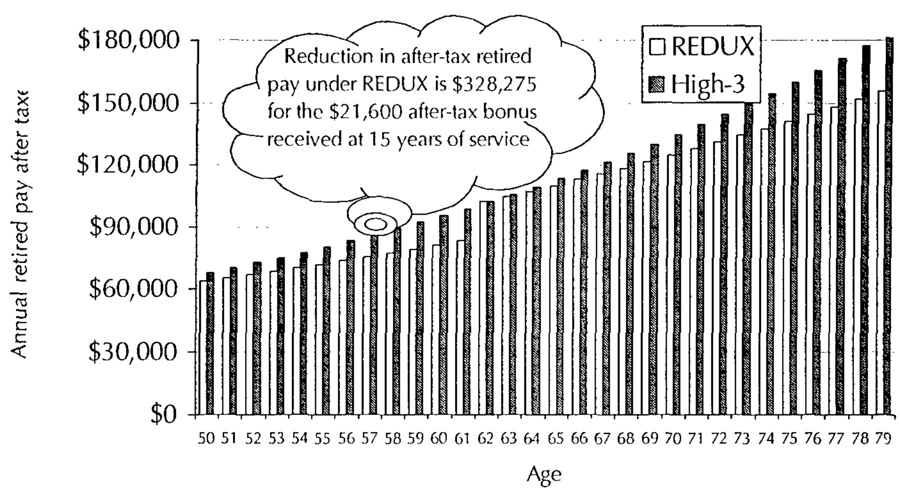


Figure 4 shows the situation for an O-6 who expects to retire at age 50 with 26 years of service. Here the officer's retired after-tax pay is $328,275 less under REDUX. (Appendix B illustrates these three situations in a different format.)

Figure 4. O-6 retiring at 50 with 26 years of service, 28% tax bracket



Let's turn next to the way we propose that servicemembers evaluate the smaller retirement pay they will receive if they select the $30,000 bonus and REDUX.

Get paid now or get paid later

Bonus-takers will get some of their retirement income early, at the 15-year-of-service point. Probably the best way to think about this is to consider REDUX's $30,000 bonus as an early cash-out of part of one's retirement pension. We can calculate how much this cash-out costs the member by thinking of it as a "loan" to be paid back later in the form of smaller retirement paychecks.

This so-called loan, given at 15 years of service, is paid back over the servicemember's entire retired lifetime. We're all familiar with car loans, mortgages, and credit card debt. Car loans and mortgages have fixed loan periods, often 5 years for cars and 30 years for mortgages. Credit card debt is a little different, requiring only a minimum payment per month. We characterize all these loans by the interest rates and interest payments attached to them.

The $30,000 bonus has a rather peculiar payback scheme. The servicemember pays nothing until retirement, pays quite a bit from the beginning of retirement until age 62, and then continues to pay back smaller amounts over the rest of his or her life. The "payments" are the differences in the height of the High-3 and REDUX bars in figures 1 through 4. Although this payment scheme is peculiar, we can calculate the implied interest rate, or APR. We have done that for a variety of situations and show the results in table 2 for enlisted personnel. The results for chief warrant officers and for commissioned officers are in appendix A.

Looking at table 2, if a servicemember expects to retire as an E-6 with 20 years of service at age 40 and lives to 79, our calculations show that, by selecting bonus/REDUX at 15 years of service, the servicemember:

- Pays an implicit interest rate of 12.2 percent for the cash-out (this is after tax)
- Loses $249,875 after-tax retirement income

- Would be required to earn at least 14.4 percent before tax *each year* until age 79 on the invested bonus to make up the difference between the REDUX pension and the High-3 pension.

Table 2. Bonus/REDUX choice for enlisted personnel (15% tax rate)[a]

Characteristics at retirement	Implicit interest rate for bonus (after tax)	Breakeven interest rate[b]	Total reduction in after-tax retirement pay	"Interest"[c]
E-6 at 20 years of service				
Age 38	12.5%	14.7%	$283,867	$258,367
Age 40	12.2%	14.4%	$249,875	$224,375
Age 42	11.9%	14.0%	$219,073	$193,573
E-7 at 20 years of service				
Age 38	13.6%	16.0%	$331,316	$305,816
Age 40	13.4%	15.7%	$291,643	$266,143
Age 42	13.1%	15.4%	$255,691	$230,191
E-7 at 22 years of service				
Age 40	11.5%	13.5%	$309,424	$283,924
Age 42	11.2%	13.2%	$270,948	$245,448
Age 44	10.8%	12.8%	$236,350	$210,850
E-8 at 20 years of service				
Age 38	14.3%	16.9%	$364,009	$338,509
Age 40	14.1%	16.6%	$320,421	$294,921
Age 42	13.8%	16.3%	$280,922	$255,422
E-8 at 22 years of service				
Age 40	12.2%	14.4%	$346,387	$320,887
Age 42	11.9%	14.0%	$303,315	$277,815
Age 44	11.6%	13.6%	$264,583	$239,083
E-8 at 24 years of service				
Age 42	10.5%	12.4%	$328,184	$302,684
Age 44	10.2%	12.0%	$286,115	$260,615
Age 46	9.8%	11.5%	$248,640	$223,140
E-8 at 26 years of service				
Age 44	9.0%	10.6%	$306,507	$281,007
Age 46	8.7%	10.2%	$266,480	$240,980
Age 48	8.2%	9.7%	$231,248	$205,748

Table 2. Bonus/REDUX choice for enlisted personnel (15% tax rate)[a] (continued)

Characteristics at retirement	Implicit interest rate for bonus (after tax)	Breakeven interest rate[b]	Total reduction in after-tax retirement pay	"Interest"[c]
E-9 at 20 years of service				
Age 38	15.4%	18.1%	$416,241	$390,741
Age 40	15.2%	17.9%	$366,399	$340,899
Age 42	15.0%	17.6%	$321,232	$295,732
E-9 at 22 years of service				
Age 40	13.1%	15.5%	$398,747	$373,247
Age 42	12.9%	15.1%	$349,164	$323,664
Age 44	12.5%	14.7%	$304,578	$279,078
E-9 at 26 years of service				
Age 44	9.7%	11.5%	$357,014	$331,514
Age 46	9.4%	11.0%	$310,391	$284,891
Age 48	8.9%	10.5%	$269,353	$243,853
E-9 at 30 years of service				
Age 48	7.2%	8.5%	$312,702	$287,202
Age 50	6.9%	8.1%	$273,155	$247,655
Age 52	6.5%	7.7%	$239,643	$214,143

a. We use the information provided at DoD's site, *http://dod.mil/mililtarypay/retirement.*

b. This is the rate of return for investing the bonus that the servicemember would need to obtain to break even between Bonus/REDUX and High-3. This rate of return would provide after-tax amounts that exactly equal the differences in pension payments under High-3/REDUX.

c. Reduction in retirement pay after excluding the after-tax bonus of $25,500.

Breaking even: What return would you need for your investment?

What is the "breakeven interest rate"? It is the before-tax interest rate that the servicemember would have to earn to equalize compensation under the High-3 vice REDUX/bonus retirement packages. For example, if one put the after-tax bonus into an investment account, that investment account would have to earn the breakeven interest rate *every* year to generate an income equal to the yearly difference in retirement pensions. And, at age 79, the account would be exhausted;

there would be no money left. If, for only one year, the member earned less than the breakeven interest rate, the account would be exhausted before the member's death.[9] The breakeven interest rates are high enough that it will be virtually impossible for anyone to break even.

Forgone retirement income

For the 40-year-old E-6 with 20 years of service, table 2 shows an "interest" payment of $224,375—the difference between the total after-tax reduction in retired pay ($249,875) and the after-tax amount of the loan ($25,500). Though all the interest rates are high, it is probably the cumulative amount of forgone retirement income that is most surprising. How do these amounts compare with those for a 30-year home mortgage? To find out, we went to ***https://www.eloan.com/s/amortcalc?context=purch***. Table 3 shows that information.

Table 3. Payments on a 30-year $30,000 mortgage[a]

Interest rate	Total amount paid	Total interest payments
6.0%	$64,748	$34,748
6.5%	$68,263	$38,263
7.0%	$71,853	$41,853
7.5%	$75,519	$45,519
8.0%	$79,246	$49,246
8.5%	$83,047	$53,047
9.0%	$86,894	$56,894
9.5%	$90,805	$60,805
10.0%	$94,781	$64,781
10.5%	$98,795	$68,795

a. Information is from *https://www.eloan.com/s/amortcalc?context=purch*

9. The breakeven interest rate is higher than the after-tax interest rate because taxes must be paid on the investment income. The breakeven interest rate times the tax rate is equal to the after-tax implicit interest rate.

Even for a 9.0-percent 30-year home mortgage loan—a *very high* interest rate by current standards—one pays back under 3 times the amount borrowed. For the after-tax portion of the $30,000 bonus, tables 2 and 3 show that the servicemember is paying back from 8 to over 16 times the bonus, or the amount borrowed![10] Why is this? **Why are the repayment amounts so large for this $30,000 "loan"?**

The easiest way to see why these repayment amounts are so large is to consider someone who dies very early in retirement. Indeed, if the servicemember dies at the retirement point, there is no repayment. The servicemember got the $30,000 at the 15-year point but died before collecting any retirement monies.[11] It is because the average life expectancy is 79 years that the repayment amounts are so large. The terms of this financial arrangement are *reduced retirement checks over the entire lifetime.*

The second reason the repayment amounts are so large is that one cannot pay off this "loan" early. If the servicemember chooses bonus/REDUX, the servicemember who lives the normal lifespan loses tremendous amounts of retirement income. The servicemember who lives *longer* than the normal lifespan loses even more.

What if you live longer than 79 years?

The longer the servicemember lives, the greater the loss in retirement income for those who chose the $30,000 bonus and the associated REDUX retirement. Table 4 shows some examples for officers and enlisted if the servicemember lives until 85, rather than 79.

The E-7 who retires at 38 with 20 years of service will pay back $438,116 in reduced retirement income for the $30,000 bonus received at 15 years of service if he or she lives to 85. Living to 90, the servicemember who took the bonus will lose $570,736 in retirement income.

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10. All calculations are after taxes. An E-6 with 20 years of service who retires at age 42 pays back $219,073 for the $25,500 ($219,073/$25,500) = 8.59; an E-9 who retires with 20 years of service at age 38 pays back 16.32 times the amount borrowed ($416,241/$25,500).

11. We have not addressed survivor benefits in this analysis, but we are concerned that the reduced retirement income will make some REDUX retirees unable to afford the Survivor Benefit Plan (SBP).

Table 4. Examples of reduction in retirement pay if bonus/REDUX is chosen: by length of life

Status at retirement			Reduction in retirement pay by length of life		
Grade	Age	Years of service	Age 79	Age 85	Difference ($)
E-6	38	20	$283,867	$375,371	$91,505
E-7	38	20	$331,316	$438,116	$106,800
CWO-3	38	20	$383,743	$507,443	$123,700
O-4	44	20	$324,983	$451,507	$126,524
O-5	44	22	$385,486	$555,280	$169,794

What if the $30,000 bonus is tax-free?

If the servicemember selects the bonus while in a combat zone, the $30,000 bonus is tax-free. How much difference should this make in the decision? We believe it should make no difference. Take the E-7 who retires at 38 with 20 years of service or the O-5 who retires at 44 with 22 years of service. If the bonus is tax-free, the E-7 will get the full $30,000 (rather than the $25,500 we assumed when the bonus was taxed) and the O-5 will get the full $30,000 (rather than the $21,600 we assumed when the bonus was taxed). Both, though, will still pay back, by reduced retirement income, the full amounts in table 4: $331,316 for the E-7 and $385,486 for the O-5. And, that's only the reduction in retirement pay if they live to age 79. As shown in table 4, if they live longer, the reductions will be larger. Both will pay back more than 10 times the amount that was advanced.

The bonus/REDUX choice

Why would one want to reject the more generous High-3 retirement plan and select the bonus and associated reduced retirement payments under REDUX? There are two main reasons:

1. Servicemembers want or feel they need the money now.
2. Servicemembers think that they can do better by investing the $30,000 than by selecting the more generous retirement plan. Under this option, there is a notion that the newly opened

federal government thrift savings plan (TSP) provides especially good investment opportunities.

Servicemembers who want or feel they need the money now should look into other ways to obtain the money. Are there alternatives for borrowing $30,000 that do not involve several hundred thousand dollars of interest payments?

Now let's clear up some misconceptions that may have arisen about the TSP. Many private-sector employees, as well as civilian federal government employees, have long had the option of putting some of their pre-tax earnings into various types of savings plans designed for retirement. TSPs either supplement private-sector pensions or, more likely, replace pensions. Retirees then supplement their Social Security in the retirement years by drawing down on the TSP.

Now servicemembers can contribute pre-tax dollars to a TSP. By participating in the TSP, uniformed personnel can save additional monies for the years they are truly retired. Because TSPs were designed to provide savings for the older years, however, there are tax penalties for any withdrawals made before age 59.5.[12] In short, do not put savings in a TSP that you anticipate needing before your sixties.

Retirement savings plans such as the TSP share one feature with conventional military retirement plans—namely, the tax-sheltering of pre-retirement income. Many servicemembers, in fact, do not seem to realize that military pensions are tax-sheltered. Retirement tax sheltering means that *no taxes are paid until the money is received in retirement.* With military pensions, the member pays no taxes on the accrued benefits until the pensions are paid in retirement. With TSP, the contributions to the TSP are before tax, and taxes are not paid until the money is withdrawn. TSPs, however, *lack* the other two important features of the High-3 retirement plan:

- Risk-free, guaranteed payments or returns
- Full inflation protection.

12. Under exceptional circumstances, the tax penalties for withdrawals before age 59.5 can be waived.

The TSP offered to military members allows the member to choose the fund, or funds, in which to invest the savings. These funds differ by the level of risk or variability of the investment returns. Funds that have higher risk will have higher average returns for long-term investors, but those returns will be more variable. None of the funds, however, have *inflation protection* or *guaranteed returns.*

TSP and the $30,000 continuation bonus

It is *merely a coincidence* that the introduction of both TSP and the choice between bonus/REDUX and High-3 occurred at the same time. Because of the timing, however, many commentators linked the two ideas, suggesting that servicemembers might elect bonus/REDUX and put the maximum amount of the bonus that can be tax-sheltered in a TSP account.

We find the linkage in the press between TSP and the $30,000 partial cash-out of the High-3 pension to be puzzling. Why would servicemembers want to give up the inflation protection provided by military retirement and invest that money in non-inflation-protected TSPs? Why would they even consider a cash-out of part of their pension when the implicit rates of interest they will pay for this are somewhat greater than the long-run return on the stock market? Why give up a riskless investment for a risky one if you can be expected to earn a lower return on the risky investment? Although we see a TSP as an opportunity for servicemembers to put a little additional money away for their old age,[13] we cannot understand why members would want to *cash out* some of their tax-sheltered, inflation-protected, guaranteed military retirement income for a TSP.

13. Saving money in a TSP is an excellent idea as long as one does not have to reduce future retirement income in order to do it. For example, saving some reenlistment bonus money or special pay in a TSP is an excellent way to ensure greater income in one's older years. The maximum amount that can be tax-sheltered in a TSP is $15,500 in 2007.

Appendix A: Officers

Table 5. Bonus/REDUX choice for chief warrant officers (25% tax rate)[a]

Characteristics at retirement	Implicit interest rate for bonus (after tax)	Breakeven interest rate[b]	Total reduction in after-tax retirement pay	"Interest"[c]
CWO-2 at 20 years of service				
Age 38	14.9%	19.8%	$342,879	$320,379
Age 40	14.6%	19.5%	$301,822	$279,322
Age 42	14.4%	19.2%	$264,615	$242,115
CWO-3 at 20 years of service				
Age 38	15.8%	21.1%	$383,743	$361,243
Age 40	15.6%	20.8%	$337,793	$315,293
Age 42	15.3%	20.5%	$296,152	$273,652
CWO-3 at 22 years of service				
Age 40	13.5%	18.0%	$369,273	$346,773
Age 42	13.2%	17.6%	$323,355	$300,855
Age 44	12.9%	17.2%	$282,065	$259,565
CWO-4 at 24 years of service				
Age 42	12.1%	16.1%	$383,030	$360,530
Age 44	11.7%	15.7%	$333,929	$311,429
Age 46	11.4%	15.2%	$290,192	$267,692
CWO-4 at 26 years of service				
Age 44	10.4%	13.9%	$361,396	$338,896
Age 46	10.0%	13.4%	$314,201	$291,701
Age 48	9.6%	12.8%	$272,659	$250,159
CWO-5 at 30 years of service				
Age 48	7.9%	10.6%	$342,384	$319,884
Age 50	7.6%	10.1%	$299,084	$276,584
Age 52	7.3%	9.7%	$262,390	$239,890

a. We use the information provided at DoD's site, *http://dod.mil/mililtarypay/retirement.*
b. This is the rate of return for investing the bonus that the servicemember would need to obtain to break even between Bonus/REDUX and High-3. This rate of return would provide after-tax amounts that exactly equal the differences in pensions under High-3/REDUX.
c. Reduction in retirement pay after excluding the after-tax bonus $22,500.

Table 6. Bonus/REDUX choice for commissioned officers (28% tax rate)[a]

Characteristics at retirement	Implicit interest rate for bonus (after tax)	Breakeven interest rate[b]	Total reduction in after-tax retirement pay	"Interest"[c]
O-4 at 20 years of service				
Age 42	17.7%	24.7%	$372,356	$350,756
Age 44	17.5%	24.3%	$324,983	$303,383
Age 46	17.1%	23.8%	$282,189	$260,589
O-5 at 20 years of service				
Age 42	18.7%	26.0%	$412,687	$391,087
Age 44	18.5%	25.7%	$360,183	$338,583
Age 46	18.1%	25.2%	$312,754	$291,154
O-5 at 22 years of service				
Age 44	15.4%	21.4%	$385,486	$363,886
Age 46	15.0%	20.9%	$334,856	$313,256
Age 48	14.6%	20.3%	$289,544	$267,944
O-5 at 24 years of service				
Age 46	12.9%	17.9%	$358,791	$337,191
Age 48	12.4%	17.3%	$310,781	$289,181
Age 50	11.9%	16.5%	$268,313	$246,713
O-5 at 26 years of service				
Age 48	10.7%	14.9%	$326,954	$305,354
Age 50	10.2%	14.2%	$283,324	$261,724
Age 52	9.7%	13.5%	$245,329	$223,729
O-6 at 24 years of service				
Age 46	13.7%	19.0%	$409,000	$387,400
Age 48	13.3%	18.4%	$354,271	$332,671
Age 50	12.7%	17.7%	$305,861	$284,261
O-6 at 26 years of service				
Age 48	11.5%	15.9%	$378,827	$357,227
Age 50	11.0%	15.3%	$328,275	$306,675
Age 52	10.5%	14.6%	$284,252	$262,652
O-6 at 28 years of service				
Age 50	9.7%	13.5%	$357,516	$335,916
Age 52	9.3%	12.9%	$311,563	$289,963
Age 54	8.9%	12.4%	$272,414	$250,814
O-6 at 30 years of service				
Age 52	8.2%	11.5%	$332,711	$311,111
Age 54	8.01%	11.1%	$293,776	$272,176
Age 56	7.8%	10.8%	$261,711	$240,111

a. We use the information provided at DoD's site, *http://dod.mil/mililtarypay/retirement*.

b. This is the rate of return for investing the bonus that the servicemember would need to obtain to break even between Bonus/REDUX and High-3. This rate of return would provide after-tax amounts that exactly equal the differences in pensions under High-3/REDUX.

c. Reduction in retirement pay after excluding the after-tax bonus of $21,600.

Appendix B: Another way of looking at figures 1 through 4

In this appendix, we show the information in figures 1 through 4 somewhat differently. Instead of looking at the retirement pay streams directly, we look at the differences in retirement pay for the two plans. Specifically, we look at the payments under bonus/REDUX minus the payments under High-3. Figures 5 through 8 show the bonus payment at the age of the servicemember at the 15-year-of-service point. Age at the 15-year-of-service point depends on when the member entered the military.

After showing the bonus payment, figures 5 through 8 give the yearly reduction in retired pay, from the point at which the member retires (for figure 5, this is at age 38). These are shown as negative amounts. Because the bonus/REDUX is set equal to High-3 at age 62, the difference between the two plans is zero at that point. The reductions in retired pay from age 63 to age 79 reflect the less than full indexing for inflation under bonus/REDUX.

Figure 5. Differences in after-tax retirement payments if bonus/REDUX is selected: E-7 retiring with 20 years of service at age 38, 15% tax bracket

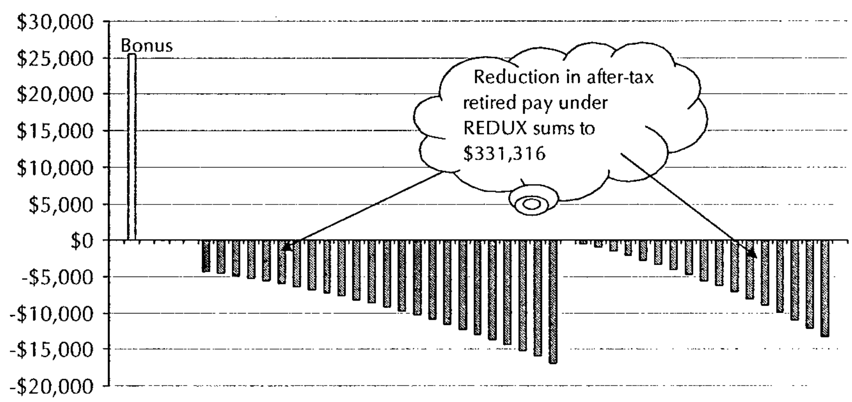


Figure 6. Differences in after-tax retirement payments if bonus/REDUX is selected: E-8 retiring with 24 years of service at age 42, 15% tax bracket

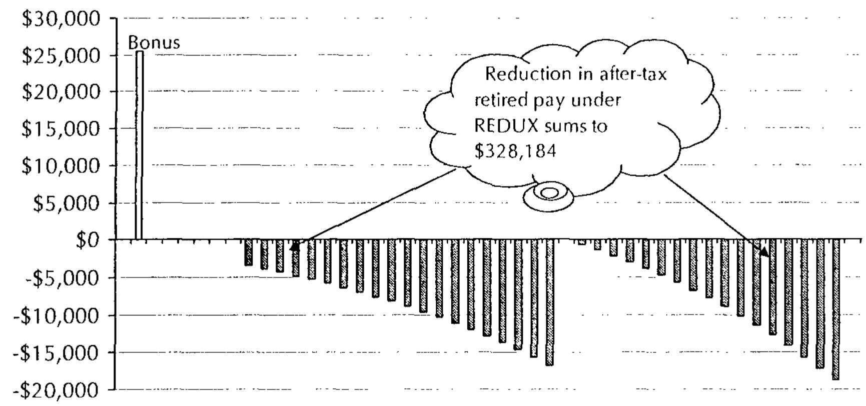


Figure 7. Differences in after-tax retirement payments if bonus/REDUX is selected: CWO-3 retiring with 20 years of service at age 38, 25% tax bracket

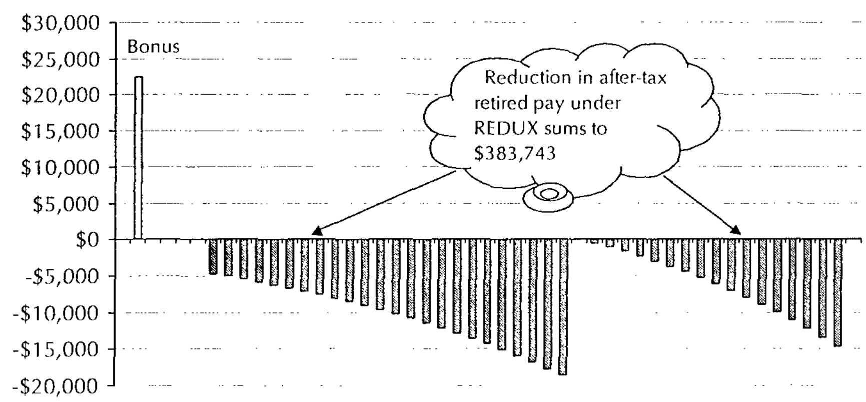
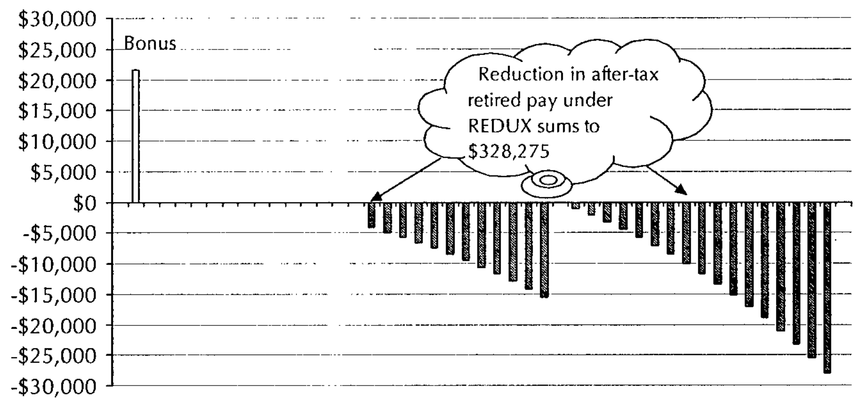


Figure 8. Differences in after-tax retirement payments if bonus/REDUX is selected: O-6 retiring with 26 years of service at age 50, 28% tax bracket



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